Economic Perspective

THE CAR PRICE CON?

by David Bell, Fraser of Allander Institute*

British car buyers are beginning to wonder whether they are the victims of a gigantic con trick. Car prices in Europe, they are told, are far lower than they are in the UK. Yet we apparently live inside a free trade area, namely the EEC, within which the market should force rough price equality after allowing for transport costs. Thus it seems that the British car buyer is being duped by the producers into paying far more for a new car than his continental cousins.

A straightforward comparison of British prices with those in the Federal Republic of Germany converted at the current exchange rate, certainly shows some massive price differentials. Some examples are shown in the Table below:

	UK Price	West German Price
Ford Granada 2.0 GL 4dr.	8828	4436
Toyota Corolla 1.3 GL 4dr.	4252	2895
VW Passat	5966	3480
BMW 528i	12355	7196
Jaguar XJ6	14729	9157
Renault 18 TL	4578	3318

UK prices include Car Tax and VAT

West German prices include motor tax (13%) and are converted at 4.28 marks to the pound.

Even allowing for some adjustments due to discounts, delivery costs etc., there are undoubtedly wide price differentials between Britain and West Germany in favour of the Germans. These differentials apply whether the car was produced in the UK, in Germany, in the rest of the EEC or imported from outwith the EEC. They cannot therefore be ascribed to distance from markets. Rather, the implications is that producers regard the British market as a 'soft touch', where consumers are prepared to pay over the odds and profits well above the norm for the rest of the EEC can be made.

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*The views expressed are those of the author and not necessarily those of the Fraser of Allander Institute.

The responsibility for the creation of the differentials seems to lie somewhere between the British car producers and the government. Domestic manufacturers have always argued the need for a profitable home market on which to base their export drive. Only Ford seems to be aware of the growing resistance to British prices, claiming that it inspired a recent price cut. The government, fearing that some of these companies might collapse completely if prevented from charging high margins in the UK, have acquiesced to widening price differentials. Rather than undercutting these prices, and run the risk of being accused of destroying the British car industry, importers have accepted the going price structure, happily taking home a much higher unit profit than they could expect in their other major European markets.

While the EEC seems to be taking the first steps toward forcing a greater degree of competition within the UK car market, there is no immediate prospect of a drastic reduction in British prices. It is therefore worth examining what are the overall effects of the price differentials on the UK economy. As a first step, therefore, let us make an estimate of their magnitude. In 1981 approximately 1.5 million cars were sold in the UK. Assume (very conservatively) that the UK price averaged £1000 more than the going price in the rest of the EEC. Then UK buyers paid at least £1.5bn more than they would have had EEC prices prevailed. This is about one and a half times the value of the 1% reduction in the National Insurance surcharge announced at the last Budget. Those benefitting from the high prices were the car producers, both the importers who claimed 55% of the market in 1981, and the domestic manufacturers. Those suffering were companies (39% of cars were registered in a company name during 1981) and private car buyers.

Thus, the maintenance of high UK prices acts as an incentive for importers to expand their share of the market, while restricting its overall size. Although BL, Ford etc. benefit in a direct manner from high prices, these very prices make it more difficult for them to maintain or expand their volume within the market. Consumers either decide not to buy new cars or have less to spend on other goods. Companies using cars, for example taxi firms, have higher costs and probably lower profits than would otherwise be the case. They too may restrict their purchases of cars.

Given that Scotland no longer produces any cars, it is difficult to see what, if any, benefits can be derived from the status quo. People in rural areas either find it more expensive to buy a car or go without. Indeed it might be argued that a reduction in car prices could have as beneficial an effect on the rural economy as all the subsidies paid to bus companies and other forms of transport. Scottish firms generally need to travel more than the UK average to reach their markets and must try to pass on their higher transport costs.

There may be grounds for supporting UK producers. BL already receives massive government support. But the grounds for extending this support by allowing car prices to rise above the competitive levels are by no means clear cut. Car buyers suffer significantly as a result while importers are given an incentive to expand their market penetration. It is not clear that any benefits to producers from higher prices outweigh these disadvantages. It does seem, however, that the Scottish economy would benefit if cars were priced as competitively here as they are on the continent.